JOHNSON & JOHNSON SDN. BHD.

v.

DIRECTOR-GENERAL OF CUSTOMS AND EXCISE

HIGH COURT MALAYA, KUALA LUMPUR
DATO' HJ. ABU MANSOR BIN ALI J.
[ORIGINATING MOTION NO.R8-25-69 OF 1989]
14 JANUARY 1993

REVENUE LAW: Sales tax - Sale by principal to distributor - Distributor in East Malaysia - Goods sold at lower price than that sold to distributors in West Malaysia - Whether distributors were independent of principal - Consideration of s. 7(1) of Sales Tax Act 1972 - Whether principal liable to pay sales tax.

INTERPRETATION OF STATUTES: Sales Tax Act 1972, s. 7(1) - Meaning of "independant".

Johnson & Johnson Sdn. Bhd, the Company, had appointed two distributors namely Sebor (Sarawak) Sdn. Bhd. and Sebor (Sabah) Sdn. Bhd. for East Malaysia under the Agency agreements dated 1 March 1982 to distribute its products. The prices of the products of the same company in West Malaysia was higher compared to the prices given to the East Malaysian distributors. The Company explained the price difference saying that it was due to the lessening of transport commission and advertising charges. The company was assessed to sales tax and penalty, on the basis of the West Malaysian sale price, totalling RM206,459 for the period from 20 October 1985 to 31 December 1987 on the basis that the distributors are not independent of the company.

The Company having failed in the Appeal before the Director General of Customs and Excise, applied for *certiorari* to quash the notice of payment of sales tax and penalty. The respondent's contention to support the notice was that under s. 7(1) (a) of the Sales Tax Act 1972, (the Act) the East Malaysian Distributors have to be independent of the company and that the East Malaysian distributors are not independent by virtue of the nature of the agency agreements between the company and them.

Held:

[1] It was the duty of the Court to ascertain the intention of the Act and the evil the taxing Act was trying to cure to decide the interpretation of the word "Independent" in the context of the case. Thus examined, what s. 7(1) of the Act was trying to cure was "arm's length transactions" entered into between not so independent entities, in which one party is showing terms favourable to the other which are not dictated by or have no relevance or relations whatsoever to ordinary and everyday current commercial considerations.

[2] In the present case the applicant had no control over the distributors and the difference in pricing to East Malaysian distributors and the West Malaysian distributors and other restrictions in the agency agreement being reasonable and practicable, to impose a sales tax using West Malaysia sale values would be unreasonable.

[3] The transactions in this case are between independent persons and the imposition of sales tax using West Malaysian sale values bringing the taxing under s. 7(1)(b) of the Act is not only a wholly unreasonable decision but also an impractical business consideration.

[Application allowed with costs].

Cases referred to:
Chin Choy & Ors. v. Collector of Stamp Duties [1979] 1 MLJ 69 ***(cit)***
Kon Fatt Kiew v. Public Prosecutor [1935] MLJ 293 ***(cit)***
Tanjong Jaga Sdn. Bhd. v. Minister of Labour and Manpower & Anor. [1987] 1 MLJ 124 ***(foll)***

Legislation referred to:
Income Tax Act, s. 35
Real Property Gains Tax Act 1976, s. 139
Sales Tax Act 1972, ss. 68(1), 7(1)(a) & (b), 20

Other sources referred to:
Encyclopedia, pp. 1-10
Halsbury's Laws of England, 4th Edn., Vol. 23
Shorter Oxford English Dictionary

For the applicant- S.Woodhull; M/s. Shearn Delamore & Co.
For the respondent- Azahar bin Hj. Mohamed, SFC

JUDGMENT

Hj. Abu Mansor bin Ali J:
By a notice of originating motion enclosure (25) dated 15 January 1992 the applicant applied for the following orders:

1. An order of *certiorari* directed to the Director-General of Customs And Excise ("the

Director-General") to remove into the High Court for the purpose of it being quashed, the notice of payment of sales tax/penalty dated 2 December 1988 whereby the applicant was assesed to sales tax and penalty totalling RM206,459 for the period from 20 October 1985 to 31 December 1987 and on which the applicant's appeal under s. 68(1) of the Sales Tax Act 1972 was rejected by the Director-General of Customs & Excise by a decision dated 28 April 1989.

2. A declaration that upon the true construction of both the Agency Agreements dated 1 March 1982 between the applicant and Sebor (Sarawak) Sdn. Bhd. and between the applicant and Sebor (Sabah) Sdn. Bhd., and other relevent facts, that the goods covered by the Agency Agreements were sold to Sebor (Sarawak) and Sebor (Sabah) as independent persons as stated in s. 7(1)(a) of the Sales Tax Act 1972 and accordingly, the notice of payment of sales tax/penalty dated 2 December 1988 and the decision of the Director General of Customs & Excise dated 28 April 1989 are wrong in law and invalid.
3. And an order that the costs of and occasioned by the motion be costs in the cause.

The applicant submitted that this application turns upon the interpretation of s. 7(1)of the Sales Tax Act 1972 (the Act) in respect of the notice of payment of sales tax/penalty by the respondent dated 2 December 1988.

The application is supported by the affidavit on behalf of the applicant enclosure (1) and the further affidavit-in-reply on behalf of the applicant enclosure (27). The respondent filed an affidavit-in-reply enclosure (26).

The applicant contends that the issue stems from the sale transactions entered between the applicant and its East Malaysian Distributors, Syarikat Sebor (Sarawak) Sdn. Bhd. (Sebor Sarawak) and Syarikat Sebor (Sabah) Sdn. Bhd. (Sebor Sabah) as evidenced in the two (2) Agency Agreements (Exhibits "AJI-3" and "AJI-4" respectively) attached to Enclosure (1).

The applicant also contends that on the facts and the law the sales transaction between the applicant and its East Malaysian Distributors were transactions between independent parties and that accordingly the price for which the goods were actually sold should be the sale value of the goods pursuant to ss. 7(1)(a) of the Act.

The respondent, however, contends that by the terms of the Agency Agreements, the Distributors are not independent of the applicant.

The material and relevant Clause 4.2 of the Agreement reads:

> 4.2 Nothing in this agreement shall create any relationship between the parties hereto other than that of Independent contractors and in no event shall distributor or any employee or agent of the distributor or any other such person or party be deemed to be the agent or employee of the company by reason of this agreement. The distributor shall not have nor represent that it has any power or right to bind the company. The company shall not be bound by or be liable for any act or acts of distributor or any of its employee or agent.

At paragraph 9 of the respondent's affidavit (enclosure 26) the respondent says that the East Malaysian Distributors are not independent of the applicant by reason of conditions and restrictions in the agreements and referred to in paragraphs 7 and 8 of the affidavit of the respondent. It is submitted that these are ordinary marketing arrangements necessary to assist in the promotion of the applicant's products and to protect the quality and improve upon their marketability (See **Encyclopaedia** pages 1-10 of Supplemental Bundle (SBA).

The applicant further submitted that paragraph 7 refers to the applicant's products selling price to distributors in West Malaysia is higher when compared to East Malaysian Distributors. The applicant submitted that this difference in price is no basis in law to impute the absense or deny the distributors' independent status.

The applicant says further that the commercial rationale for the said price difference above are (see enclosure 27):

> 3. the applicant's products in West Malaysia are sold direct to retail outlets like departmental stores etc. and not through Distributors. In some cases amongst the 40,000 there are cases where the small retailers buy from the big ones.
> 4. In East Malaysia, the applicant's products are sold out at a price lower than West Malaysia, to Sebor Sarawak distributors there and they in turn sell the applicant's products to retailers like the departmental stores. The common ordinary cost of marketing, warehousing etc. including extension of credits and collection of bad debts are, in

East Malaysia, borne by the two distributors while the same costs are borne by the applicant in West Malaysia.

The applicant submitted that the inference put by the respondent (see paragraph 8 of the enclosure 26) that the Distributors' independence is ousted by reason of the conditions and restriction found in the contractual agreements entered between them is incorrect and unfounded in law and their independence can be assessed by the measure of legal control one has over the other. The equity holding of the Distributors Sebor Sarawak and Sebor Sabah are set out in "AJI-5" and "AJI-6". The rights of the Distributors under the agreements were assigned to Sebor (Sarawak) Trading Sdn. Bhd. (Sarawak Trading) and Sebor (Sabah) Trading Sdn. Bhd. (Sabah Trading) and their directorships and shareholding are set out in "AJI-9" and "AJI-10" of enclosure (1).

The Shorter Oxford English Dictionary (PI) gives the ordinary meaning of 'independent' as not depending upon the authority of another; not in a position of subordination; not subject to external control or rule; self-governing, free.

The applicant says under s. 35 of the Income Tax Act (ITA) a market value consideration is placed in the valuation of certain stock-in-trade.

The applicant's Counsel submitted that if the words "independent person" is ambigous, the examination of subsequent statutes may throw light on the interpretation of earlier Enactments. He submitted that Real Property Gains Tax Act 1976 (RPGTA) is part of the body of revenue law that came after this Act. It provides different treatment where the transaction is not between independent persons. In such event, the value to be put on such transaction would be at market value. Controlled companies are defined in s. 139 of the Income Tax Act (page 211 of Bundle of Authorities). They are identified by the majority or greater element in the subservient company's share capital or voting power or he possesses, he is entitled, to greater part be it issued share capital, or amount to be distributed.

The applicant submitted that, on the consideration of the authorities, the respondent has given a strange and unnatural meaning to the words "independent persons" under s. 7 of the Act. He submitted further the respondent has assumed an unbridaled right to determine the matter of an independent person merely out of commercial agreement that set out the conditions to be observed by one party when the conditions in no way encroach upon the management and affairs of each party. He submitted to this extent, the decision of the respondent needs to be regarded as a nullity in law.

The applicant hereby submitted that on the facts and the law no control of any nature could have been excercised by the applicant over the distributors either through the ownership of shares in the distributors' companies or through any entitlement to exercise voting or management rights through directorships in those companies.

The applicant's Counsel submitted that the respondent's contention that the contractual terms and conditions give rise to altered legal status would lead to absurdity and he submitted that the interpretation so given by the respondent to the words "independent persons"is forced and unnatural and should not be accepted by a Court of law. If the words are ambiguous and capable of different interpretations, then it should be settled, so Counsel submitted, in favour of the tax-payer - for his benefit.

Finally the applicant submitted that from **Halsbury's Laws of England,** 4th Edn., Reissue Vol. 23 - it is trite law that it is a general principle of fiscal legislation that to be liable to tax the subject must fall clearly within the words of the charges imposing the tax and it is for the Crown to establish that the charge extends to the subject matter sought be charged.

As submitted on the basis of the foregoing facts and the law, the applicant prays for the order sought be granted.

For the respondent the interpretation sought before the Court turns on the word "independant" in s. 7(1)(a) of the Act which reads:

> (1) For the purposes of this Act this sale value of goods shall be -
>
> (a) in the case of goods sold by a taxable person to a person independent of him the price for which the goods are actually sold.

At page 15 of the respondent's submission they submitted that the respondent states that Sebor Sarawak and Sebor Sabah are not independent of the applicant. The respondent's reasons are

stated in paragraph 7 which I have mentioned and paragraph 8 which reads as follows:

> .....I had examined carefully these agreements (agency agreements) during the said examination. The relevent positions are as follows:
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> During the terms of this agreement, company shall provide the Distributor with pricing and allowing Distributor with structures margin on sales of 12% and 17% on Sanitary respectively. Both these product groups are only as per mentioned in the annexed First Schedule and the margin herein specified will not apply to additional products .... Under no circumstances shall Distributor vary pricing structures to trade unless otherwise agreed in writing with the company.

The agreements provide how the products are to be warehoused and in the event of any defect how they are to be replaced. The agreement also has provided how advertising of the products are to be done. The distributors are also to give the applicant reports of market conditions there and of the sales progress of the company's products. The distributors agree not to sell or otherwise distribute or deal in goods that are in competition with the applicant's products in the Territory unless the company gives prior consent.

The respondent submitted that the conditions and restrictions in the Agency Agreement are not imposed on distributors in West Malaysia. It was in accordance with section 20 of the Act, the respondent decided that tax assesment shall be determined based on the sale value under s. 7(1)(b). It is the respondent's contention that Sebor Sarawak and Sebor Sabah are not independent of the applicant.

The resopondent submitted that the word "independent" in s. 7(1) of the Act must be given its ordinary meaning citing *Chin Choy & Ors. v. Collector of Stamp Duties* [1979] 1 MLJ 69. The respondent's Counsel also submitted what is basic to taxing law and the words must be given its ordinary meaning and one can consult any standard general dictionary if in doubt. Citing *Kon Fatt Kiew v. Public Prosecutor* (1935) MLJ 293.

Respondent submitted that "Independent" means the same thing as has been submitted by the applicant, as not dependent, not subject to control.... self governing.

The respondent submitted that applying the meaning of the word "Independent" it is the respondent's submission that the distributor is not independent of the applicant. The respondent submitted that from the terms of the agreement where the applicant requires the Distributors to follow their advice in matters of the sale and advertising or generally on the products to be sold, because of the applicant's vast experience, which advice the Distributors must accept. This shows the extent of the authority and control of the applicant over the Distributors. The respondent, therefore, submitted that the Distributors are not independent of the applicant.

The respondent's Counsel submitted that the meaning given by the applicant to the word "independent" is that the applicant has no control in respect of the Distributors' Board of Directors or their shareholding and this is incorrect. Counsel submitted the word must be given its ordinary meaning and if this narrow approach is taken, which should not have been taken by the applicant, this, respondent's Counsel submitted, would not have involved implying something wholly inconsistent with the word expressly used in the Act. Counsel therefore submitted "independent" does not have the meaning of independent of legal control.

After hearing arguments I find that parties in this case have large areas that divide them. For the applicant they say the term independent must be interpretted as legal control of the Distributors companies by the applicant through directorships or shareholding and the respondent say the terms of the agreement must be looked at and if it so done then it would reveal that the Distributors are not independent of the applicant.

In interpreting the word "independent" in the context of the said agreement, I have to find the intention of the Act that is before me and I ask what was the 'evil' that this Taxing Act was trying to cure? I think the answer is if the intention of the Act is gathered from its wording and we consider the words used in s. 7(1) it is abundantly clear what this section tries to cure was in the commercial language is called "arm's length transaction". If my understanding of the term is correct, it means that the Act abhores such a transaction and attempts to strike a blow at transactions entered between two not so independent entities such as between holding companies and their subsidiary and or vice versa which can be called transactions but when

examined and dissected in detail reveals one party showing terms favourable to the other which are not dictated by or have no relevance or bears no relations whatsover to ordinary and everyday current commecial considerations.

In deciding this problem before me, I follow the classic and illuminating case of *Tanjong Jaga Sdn. Bhd. v. Minister of Labour and Manpower & Anor* [1987] 1 MLJ 124 and adhere to the judgement of Abdoolcader SCJ when he said although the Registrar (or authority) has an unfettered discretion which was subject to a duty to act responsibly in the *Wednesbury* sense but if the decision-making body comes to its decision on no evidence or comes to an unreasonable finding so unreasonable that a resonable person would not have come to it - then the Courts will interfere.

I looked at the terms of the agency agreement between the parties and the submission of the law made by both sides, I make a finding that the agreements so entered are between independent parties in the sense that there has been no arm's length transaction here but in fact according to the parties' intention of a plain commercial transaction regarding arrangements of the sale of applicant's products in a certain way serving the need of each party and to satisfy both in accordance with the prevailing trade practice.

I considered that the product is manufactured in Petaling Jaya, West Malaysia and it is to be eventually sold in Sarawak or Sabah and so in order that the company's commodity can be sold in those far-away distant land at not too high a price, the Distributors must necessarily be given all the incentives, such as lessening for transport commission and advertising charges. All these must be paid by the manufacturers in terms of lessening the price to be sold to the far-away distant Distributors, Sebor Sarawak and Sebor Sebah. For the protection of the manufacturers and necessarily in order to ensure successful sales of their products, they imposed conditions that the Distributors would not sell goods of any competitor of the similar products. Common sense tells us that with all expenses incurred to ensure their successful sales of these products in these distant lands, the the sale cannot be at the same price or sales value of those products in West Malaysia.

That being the case, the terms of these transactions between the parties, by discounting these expenses to East Malaysia Distributors, as opposed to the sales figures to West Malaysia Distributors, I find their sales value to those Distributors in East Malaysia, in particular to Sebor Sarawak and Sebor Sabah, as most reasonable and practical. To impose a sales tax on sales values of sales the same as in West Malaysiya would result in the applicant paying twice and also in the price of the goods being increased on the shelves to higher than it is now and clearly that could result in decrease or abortive sales.

With all these considerations, I cannot say that the transactions are not between 'independent' bodies - they are so, I find to be between independent persons free to strike clear and proper bargain, not at arm's length and the imposition of sales tax using West Malaysia sale values bringing this taxing under s. 7(1)(b) of the Act is, in my considered view, not only a wholly unreasonable decision but also an impractical business consideration. In accordance with the case of *Tanjong Jaga* cited, I make an order in terms prayed for by the applicant with costs to be taxed.